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**(ECF CASE)**

**UNITED STATES DISTRICT COURT**

**SOUTHERN DISTRICT OF NEW YORK**

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| RAYMOND J. KADAGIAN, On Behalf of Plaintiff and All Others Similarly Situated,<br><br>Plaintiff,<br><br>vs.<br><br>H&R BLOCK, INC., MARK A. ERNST, JAMES W. YABUKI, AND WILLIAM L. TRUBECK,<br><br>Defendants. | **Civil Action No. 06 CIV. 2306**<br><br>**CLASS ACTION COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS**<br><br>**JURY TRIAL DEMANDED** |

Plaintiff, individually and on behalf of all other persons similarly situated, by plaintiff's undersigned attorneys, for plaintiff's complaint against defendants, alleges the following based upon personal knowledge as to plaintiff and plaintiff's own acts, and upon information and belief as to all other matters, based on, inter alia, the investigation conducted by and through plaintiff's attorneys, which included, amongst other things, a review of the defendants' press releases, Securities and Exchange Commission ("SEC") filings by H&R Block, Inc. ("H&R Block" or the "Company") and media reports about the Company. Plaintiff believes that substantial evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

## NATURE OF THE CASE

1. This is a securities class action on behalf of plaintiff and all other persons or entities, except for defendants, who purchased or otherwise acquired H&R Block securities ("the "Class") during the period February 24, 2004 and through March 14, 2006, inclusive (the "Class Period"), seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").

2. H&R Block provides various financial services to the general public, principally in the United States, as well as in Canada, Australia, and the United Kingdom. Its tax operations include tax return preparation, filing, and other services and products related to income tax return preparation in the United States. The company's investment products and services include traditional brokerage products, as well as retirement accounts, annuities, insurance, fee-based accounts, online account access, equity research and focus lists, model portfolios, asset allocation strategies, and other investment tools and information. The company's mortgage operations originate mortgage loans, service nonprime loans, as well as sell and securitize mortgage loans and residual interests. The company also offers accounting, tax, and consulting services to middle-market companies. These services include wealth management, retirement resources, payroll services, corporate finance, and financial process outsourcing.

3. During the Class Period, defendants caused H&R Block's shares to trade at artificially inflated levels through the issuance of false and misleading financial statements. As a result of this inflation, H&R Block was able to (i) offer for sale and sell $400 million 10-year senior unsecured notes, in reliance on defendants' false and misleading financial reports; (ii) declare higher quarterly stock dividends than might otherwise be possible absent the sale of its debt securities; and (iii) award defendants cash and stock-based compensation based in part on the inflated value of the Company's stock.

4. Defendants concealed the false and misleading nature of the Company's financial statements and continued in their concealment of their false and misleading financial statements throughout the Class Period. Defendants continued in their concealment, even though the

Company had assured investors in July of 2004 that, except for minor non-material issues with its accounting internal controls, the Company's accounting controls were effective.

5. At the same time, defendants also concealed the Company's potential exposure to lawsuits stemming from the fraudulent nature and operation of their investment products. Unbeknownst to investors, defendants induced their customers to open investment accounts, using a marketing strategy that consistently misrepresented the benefits and concealed the deficiencies of those accounts. On the basis of confidential communications dating from prior to the beginning of the Class Period, there can be no doubt that defendants were well of the deceitful nature of this marketing strategy and scheme. In fact, the Company's CEO noted that, "…the product is designed to nickel and dime clients to the point where our field people don't feel as good about the product as they should."[1]

6. On June 8, 2005, H&R Block revealed that its financial reports for its 2003 and 2004 fiscal years and the first three quarters of its 2005 fiscal year contained numerous accounting errors in the tens of millions of dollars and would be restated. On July 8, 2005, defendants revealed that the Company's restatement of its financial reports for 2003 and 2004 and its annual report for 2005 would be further delayed. As the Company delivered its news of the restatement and filing delays, the price of H&R staged a significant decline, losing as much as 18% of their value over a two month period, until achieving a low of $23.89 on September 26, 2005.

7. Then, on February 23, 2006, after the close of the markets, defendants shocked investors with the news that the Company's management and its Audit Committee, in consultation with the Company's independent auditors, KPMG LLP, would undertake a

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[1] See the Complaint of the NYS Attorney General Eliot Spitzer, against H&R Block, Inc., and H&R Block Financial Advisors, Inc. of March 15, 2006, at http://www.oag.state.ny.us/press/2006/mar/H%20&%20R%20BLOCK%20COMPLAINT.pdf and document bates no. 0090229 at http://www.oag.state.ny.us/press/2006/mar/HR%20Block%20Exhibits%20(Final).pdf, last accessed on March 15, 2006.

restatement of the Company's previously issued consolidated financial statements, including fiscal year 2006 quarterly financial statements and financial statements for the fiscal years ended April 30, 2005 and 2004. Following the Company's shocking announcement, the price of the Company's shares plummeted from its previous close on February 23, 2006 of $25.19, for a loss of $2.23, losing another 8.85% percent of their value, trading at a midday low of $22.96 on February 24, 2006, on midday volume of over 5.9 million shares, ***nearly four times normal daily volume.***

8. Finally, on March 15, 2006, investors learned of a $250 million lawsuit by the NY Attorney General, addressing fraudulent marketing practices involving the Company's IRA products. The suit deflated the expectations of the investment community, in reliance on promised results from the Company's Financial Advisory segment.

9. The lawsuit, in combination with the Company's prior corrective disclosures, pointed the investment community to a pervasive pattern of erroneous, false, misleading and deceitful communications regarding the Company's products, financial statements and prospects. As a result, the price of H&R Block shares tumbled again, from the previous close of $22.00 on March 14, 2006, to close $20.63 on March 15, 2006, for a loss of $1.37 or another 6.2% percent, on volume of over 14 million shares, nearly seven times normal daily volume.

10. During the Class Period, defendants knew and concealed that:

(a) a series of internal control weaknesses existed in the Company's corporate tax accounting function;

(b) uncorrected accounting errors were significant and remained uncorrected for more than a year after control weaknesses were discovered;

(c) the Company ***offered for sale and sold $400 million 10-year senior unsecured notes***, despite significant uncorrected errors in the Company's financial statements;

(d) accounting for acquisitions (primarily the acquisition of Olde Financial Corporation in fiscal year 2000) had resulted in an understatement of deferred tax liabilities and goodwill ***of approximately $129 million,*** impacting fiscal years 2000 through 2004;

(e) the Company had overstated its provision for income taxes in connection with acquisitions ***by approximately $11 million*** for each of the fiscal years ended April 30, 2004 and 2003;

(f) accounting for a gain on sale of previously securitized residuals in fiscal year 2003 resulted in a net overstatement in revenues for that year ***of approximately $36 million;***

(g) Company accounting for leases resulted in a cumulative overstatement of retained earnings ***of approximately $7 million*** as of April 30, 2004;

(h) accounting errors pertaining to the Company's provision for income taxes resulted in a cumulative overstatement ***of approximately $10 million to $14 million in retained earnings*** as of April 30, 2004;

(i) a calculation error pertaining to an incentive compensation accrual at the Company's Mortgage Services segment resulted in an understatement of pre-tax expense in fiscal year 2004 ***of $12.4 million;***

(j) overstatement of capitalized branch office costs at the Company's Investment Services segment and a corresponding understatement of operating expenses resulted in an understatement of pre-tax expense ***of approximately $4 million in fiscal year 2004 and $2 million in fiscal 2003;***

(k) errors pertaining to the Company's state effective income tax rate for the fiscal quarters ended October 31, 2005 and July 31, 2005, fiscal years ended April 30, 2005 and 2004 and the fiscal quarters for fiscal years 2005 and 2004 resulted in a cumulative understatement of state income tax liability, net of federal income tax benefit, of approximately $32 million as of April 30, 2005; and

(l) the Company had adopted fraudulent marketing practices for its IRA investment products, at the risk of lawsuits and government action, within the Company's troubled Financial Advisory segment.

## JURISDICTION AND VENUE

11. Jurisdiction is conferred by §27 of the 1934 Act. The claims asserted herein arise under §§10(b) and 20(a) of the 1934 Act and Rule 10b-5.

12. Venue is proper in this District pursuant to §27 of the 1934 Act. The corporate headquarters of H&R Block are located in the District.

13. In connection with the acts and conduct alleged herein, defendants, directly and indirectly, used the means and instrumentalities of interstate commerce, including the United States mails and the facilities of the national securities exchanges.

## PARTIES

14. Plaintiff purchased shares of H&R Block stock at artificially inflated prices during the Class Period as described in the attached certification and was damaged thereby, as set forth in the accompanying certification, incorporated by reference herein.

15. Defendant provides various financial services to the general public, principally in the United States, as well as in Canada, Australia, and the United Kingdom. Its tax operations include tax return preparation, filing, and other services and products related to income tax return preparation in the United States. The company's investment products and services include traditional brokerage products, as well as annuities, insurance, fee-based accounts, online account access, equity research and focus lists, model portfolios, asset allocation strategies, and other investment tools and information. The company's mortgage operations originate mortgage loans, service nonprime loans, as well as sell and securitize mortgage loans and residual interests. The company also offers accounting, tax, and consulting services to middle-market companies. These services include wealth management, retirement resources, payroll services, corporate finance, and financial process outsourcing. H&R Block was organized in 1955 and maintains its corporate and administrative offices, where the Company's day-to-day business activities are conducted, at 4400 Main Street, Kansas City, Missouri.

16. Defendant Mark A. Ernst ("Ernst") was Chairman and CEO for the Company. Ernst was hired Company executives with expertise needed to offer clients financial services and was responsible for improvements to the Company's planning processes. Ernst was a Certified Public Accountant, whose experience included previous positions with PricewaterhouseCoopers (Coopers & Lybrand) and U.S. Treasury Department's Comptroller of the Currency. On June 9, 2005, defendant Ernst received a $398,640 cash bonus, 150,000 stock options and 15,000 restricted shares as incentive compensation for fiscal year 2004.[2]

17. Defendant Jeffrey W. Yabuki ("Yabuki") was Executive Vice President and COO of the Company during the Class Period. Yabuki's experience includes his previous position as president and chief executive officer of American Express Tax & Business Services, managing all aspects of the company's tax, accounting and consulting businesses. Yabuki holds CPA certificates in California and Minnesota, a NASD Series 7 license, and is a past member of the Minnesota Board of Accountancy. On June 9, 2005, defendant Yabuki received a $145,174 cash bonus, 80,000 stock options and 8,000 restricted shares as incentive compensation for fiscal year 2004.[3] On November 18, 2005, defendant Yabuki sold 674,118 shares of his H&R Block stock, for proceeds of $16,398,392.

18. Defendant William L. Trubeck ("Trubeck") was Executive Vice President and CFO of the Company during the Class Period. Trubeck's experience includes his previous position as Chief Financial Officer and Chief Administrative Officer of Waste Management, Inc., where he was responsible for oversight of the corporation's financial affairs, established an internal audit department and developed "Accounting Rules of the Road."

19. The individuals named as defendants in ¶¶16 -18 are referred to herein as the "Individual Defendants." The Individual Defendants, because of their positions with the Company and its business segments, possessed the power and authority to control the contents of

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[2] See SEC Form 8-K, filed by defendants on June 9, 2004.

[3] Id.

H&R Block quarterly reports, press releases and presentations to securities analysts, money and portfolio managers and institutional investors, *i.e.*, the market. Each defendant was provided with copies of the Company's reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions and access to material non-public information available to them but not to the public, each of these defendants knew that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations which were being made were then materially false and misleading. The Individual Defendants are liable for the false statements pleaded herein, as those statements were each "group-published" information, the result of the collective actions of the Individual Defendants.

## SCIENTER

20. In addition to the above-described involvement, each Individual Defendant had knowledge of H&R Block's problems. Each defendant was motivated to conceal such problems, consistent with their efforts to represent the business as a reputable financial services Company. Defendant Trubeck, as CFO, provided for financial reporting and communications with the market. Communications with the market, including conference calls, as well as internal reports showing H&R Block's forecasted and actual growth were prepared under their direction. Defendant Ernst, having served as CEO also provided for communications with the market, including conference calls, as well as reports on Company operations, financing and press releases issued by the Company. Each Individual Defendant sought to demonstrate that he could lead the Company successfully and generate the growth expected by the market. Each individual defendant also owed a duty to the Company and its shareholders not to trade on inside information.

## FRAUDULENT SCHEME AND COURSE OF BUSINESS

21. Each defendant is liable for (a) making false statements, ***or*** (b) failing to disclose adverse facts known to him about H&R Block. Defendants' fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of H&R Block publicly traded securities was a success, as it (a) deceived the investing public regarding H&R Block's prospects and business; (b) artificially inflated the prices of H&R Block's publicly traded securities; (c) allowed Company insiders, including defendants, to sell millions of dollars of Company stock at artificially inflated prices; and (c) caused plaintiff and other members of the Class to purchase H&R Block's publicly traded securities at inflated prices.

## DEFENDANTS' FALSE AND MISLEADING STATEMENTS MADE DURING THE CLASS PERIOD

22. On February 24, 2004, defendants issued a press release entitled, "H&R Block Reports 59 Cents Per Share Third Quarter Profit - Early Tax Season Results Consistent with Full Year Guidance". The press release stated in part:

> KANSAS CITY, Mo. – H&R Block Inc. (NYSE:HRB) today reported net income of $106.7 million, or 59 cents per diluted share, and record revenues of $977.2 million for the third quarter ended Jan. 31.
>
> Third quarter revenues increased 2 percent from $958.4 million last year. Third quarter net income declined $25.6 million or 19.3 percent compared with last year when the company reported third quarter earnings of $132.3 million, or 73 cents per diluted share. Third quarter 2004 results include a $17 million gain on sale of certain mortgage assets. Third quarter 2003 results include a $130.9 million gain on a similar transaction. Excluding the effect of these gains, third quarter net income increased $42.9 million or 80.2 percent over the prior year.
>
> The profitable third quarter marks the first time in the company's history that it has reported a profit in each of the first three quarters of its fiscal year. H&R Block typically reports losses in its first and second quarters, and often in its third quarter as well, due to the seasonal nature of its tax and business services units.
>
> "All of our business segments executed effectively and delivered improved performance. We saw double-digit revenue growth in each of our businesses, excluding the mortgage asset sales that we've noted," said Chairman and Chief Executive Officer Mark A. Ernst.

"Performance in the tax filing season thus far is consistent with our overall expectations for a good, but not great, tax season," Ernst said. "After a slow start, growth in retail tax filing has accelerated in the month of February and our digital tax services are growing very well."

The quarter results included $6.8 million in stock-based compensation expense, an expense that was not included in the comparable quarter last year. H&R Block began to expense the costs of stock-based compensation at the beginning of the current fiscal year.

For the nine-month period ending Jan. 31, the company reported net income of $122.3 million, a 43.1 percent increase compared with last year. Earnings per diluted share increased 45.7 percent to 67 cents. Revenues for the nine month period increased 10.8 percent to $2.1 billion.

On a consolidated basis, the company continues to expect fiscal 2004 GAAP earnings-per-share in the range of $3.65 to $3.85 and revenue growth at the high end of its target range of 10 to 15 percent. Included in these expectations is about $24 million or 8-cents per share, of non-cash stock-based compensation expenses.

U.S. Tax Operations

U.S. Tax operations reported pretax earnings of $68.2 million, compared with $34.1 million last year, an improvement of $34.1 million. U.S. tax operations reported a 14.9 percent increase in revenues for the quarter to $463.6 million, compared with $403.6 million last year.

Compared with last year, the improved performance is due to an increase in the number of clients served, increased revenue per client and better expense management. These improvements were partially off-set by expenses related to adding 873 tax locations to the company's retail network, including 459 company-owned offices in former franchise territories. Company-owned offices in former major franchise territories contributed $24.3 million to the increase in revenues.

For the nine-month period, revenues increased 19.8 percent to $551.4 million, up $91.1 million from $460.3 million last year. The segment reported a $155.9 million pretax loss for the nine-month period, an improvement of $56.3 million or 26.5 percent compared with the $212.2 million pretax loss last year.

From Jan. 1 through Jan. 31, tax preparation and related fees from retail tax offices increased 8.6 percent to $500.3 million. The average fee per client served rose 8.9 percent to $134.99. Total clients served, including office and digital tax solutions clients, increased 4.6 percent to 5 million. Retail tax offices served 3.7 million clients, a 0.2 percent decline from last year. Clients served by H&R Block's digital tax solutions increased 21.7 percent.

For the tax season through Feb. 15, tax preparation and related fees from retail tax offices increased 3.9 percent to $1.1 billion. In the period ending Feb. 15, the average fee per client increased 8 percent to $135.48. Total clients served, including office and digital tax solutions clients, increased 0.1 percent to 9.9 million. Retail tax offices served 7.9 million clients, a decline of 3.9 percent from last year. Clients served by H&R Block's digital tax solutions increased 19.6 percent. However, year-over-year comparisons must be viewed cautiously due to

the intra-week variability of tax filings and the difference in the days of the week included in the comparative periods.

"While we saw a slow start to the tax filing season in our retail offices, the growth that we are seeing in February and the mix of clients that are coming to H&R Block indicate that we are likely to be at the lower end of our expected range for retail client growth and at the higher end of our expected range for revenue per client," Ernst said. "Combined with superior performance in our digital businesses, we believe that we are on track to meet our overall targets for the year."

Mortgage Operations

Mortgage operations, which include Option One Mortgage Corp. and H&R Block Mortgage Corp., reported pretax earnings of $154.5 million for the quarter, a $108 million decrease compared with pretax earnings of $262.5 million last year. For the nine-month period, pretax earnings decreased 10.8 percent to $502.3 million, compared with $563.1 million last year.

Third quarter revenues from mortgage operations decreased 16.4 percent to $331.9 million, compared with $397 million last year. For the nine-month period, revenues increased 7 percent to $986 million, compared with $921.9 million last year.

Third quarter 2004 results include a $17 million gain on sale of certain mortgage assets. Third quarter 2003 results include a $130.9 million gain on a similar transaction. Excluding the effect of these gains, third quarter pretax income from mortgage operations increased 4.5 percent.

"We're pleased with the mortgage segment results, which continue to meet our expectations. These results support our long-held view that the interest rate environment would not have a significant effect on our mortgage performance. Overall origination activity continued to be strong in the quarter, while margins declined somewhat as we had expected." Ernst said.

For the third quarter, the company originated $5.4 billion in mortgage loans, an 18.1 percent increase over last year's $4.5 billion. The number of loan originations in the third quarter was 35,795, a 15.8 percent increase compared with last year.

Mortgage servicing revenues for the quarter were $55.1 million, an increase of $11.7 million, or 27 percent, compared with $43.4 million last year. On Jan. 31, 2004, the servicing portfolio was $42.2 billion, an increase of $13.3 billion, or 46 percent, compared with Jan. 31, 2003, and up 5.2 percent over the previous quarter.

Third quarter pretax income from H&R Block Mortgage increased 25.9 percent. Nearly 40 percent of the company's retail loans were to clients of other H&R Block businesses.

The segment's residual interests continued to perform better than expected, primarily due to better than modeled loss and interest rates. Consequently, the company realized a net write-up in residual balances of $36 million, which was

recorded in other comprehensive income on the balance sheet, net of deferred taxes.

Business Services

RSM McGladrey Business Services Inc. reported third quarter revenues of $112.3 million, an 11.5 percent increase compared with $100.7 million last year. The segment reported pretax earnings of $2 million, a $6.2 million improvement, compared with a loss of $4.2 million in the third quarter last year.

For the nine-month period, revenues increased 8.8 percent to $319.8 million. The segment reported a pretax loss of $7.5 million compared with a pretax loss of $12.3 million last year.

"Our capital markets business enjoyed another strong quarter compared with last year. Higher fees in our core accounting and tax services also contributed to improved performance," Ernst said.

Investment Services

H&R Block Financial Advisors Inc. reported third quarter revenues of $57.8 million, an increase of 20.2 percent compared with the same quarter last year. The segment reported a pretax loss of $12.8 million, a 59.7 percent improvement compared with last year's pretax loss of $31.8 million.

"We saw strong improvement in all of the key drivers of the business this quarter," Ernst said. "Overall, results of our Financial Advisors business reflect sustained changes that should allow us to have continuing performance improvement."

For the nine-month period, revenues increased 6.8 percent to $167.4 million, compared with $156.7 million last year. The segment reported a pretax loss of $41.9 million compared with $92.5 million in the first nine months of last year, which included $24 million in goodwill impairment charges.

International Tax Operations

In the third quarter, revenues from international tax operations increased 23.6 percent to $10.8 million, compared with $8.8 million last year. The segment reported a pretax loss of $6.4 million, compared with a pretax loss of $5.7 million last year.

For the nine-month period, revenues increased 24.7 percent to $35.4 million. The segment reported a $12.3 million pretax loss, compared with last year's pretax loss of $12.4 million.

"We enjoyed a successful conclusion to the tax season in Australia. However, unfavorable exchanges rates in Canada resulted in a higher loss for the quarter," Ernst said.

Dividend declared

H&R Block's board of directors declared a quarterly cash dividend of 20 cents per share, payable April 1, 2004, to shareholders of record March 11, 2004. This payment will be the company's 166th consecutive quarterly dividend.

Share repurchases

During the third quarter, the company repurchased 3.7 million shares of its common stock at an aggregate cost of $192.3 million, or an average price of $52.61 per share. Year to date, the company has repurchased 7.8 million shares at an aggregate cost of $370 million, or an average price of $47.51 per share.

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23. On June 9, 2004, the Company issued a press release entitled, "H&R Block Reports Record Annual Revenues And Earnings - Company Announces Dividend and Share Repurchase Authorization Increases". The press release stated in part:

H&R Block Inc. (NYSE: HRB) today reported record revenues and net income for both its fourth quarter and fiscal year ended April 30.

Fourth quarter revenues totaled $2.2 billion, a 14.8 percent increase over the fourth quarter last year. Consolidated net income for the quarter increased 16.4 percent to $575.6 million. Fourth quarter earnings per diluted share increased 19.2 percent to $3.23.

Fiscal year revenues increased 12.3 percent to $4.2 billion. Consolidated net income for the fiscal year increased 20.3 percent to $697.9 million. Earnings per diluted share increased 23.8 percent to $3.90, excluding a change in accounting principle. After the change in accounting principle, earnings per share increased 22.5 percent to $3.86. The company adopted Emerging Issues Task Force No. 00-21 (EITF 00-21) in its second quarter.

"Fourth quarter results completed a year that saw record revenues, record earnings and balanced growth from our mix of businesses," said H&R Block Chairman and Chief Executive Officer Mark A. Ernst. "We experienced improved results across all business lines in our fourth quarter.

"H&R Block's combined annual growth rate for earnings per share has increased 29 percent in the past five years. Our mix of businesses has generated solid results, even in challenging business environments," Ernst said.

H&R Block began to expense the costs of all stock-based compensation at the beginning of fiscal year 2004. The fiscal year results include $25.7 million, or 9 cents per diluted share, in stock-based compensation expense, compared with $2.1 million last year.

Fiscal 2005 Outlook

"Next year, we expect earnings per share in the range of $4.00 to $4.25 per share. We expect solid growth in our mix of businesses. We continue to believe that,

over the long-term, the company's mix of businesses can generate earnings consistent with our long-term guidance of earnings per share growth in the range of 13 to 18 percent per year," Ernst said.

"A changing interest rate environment will likely result in a flattening or slight decline in mortgage earnings, which will partially offset solid earnings growth in our other businesses," he said.

Board Actions

Reflecting the company's strong financial condition and continuing performance, H&R Block's board of directors approved an increase of the quarterly cash dividend from 20 cents to 22 cents per share, a ten percent increase, effective with the quarterly dividend payment on Oct. 1, 2004 to shareholders of record on Sept. 10, 2004. This payment will be the company's 168th consecutive quarterly dividend.

Also, the board authorized the company to repurchase up to 15 million of its shares, in addition to the 11.3 million shares remaining at year end on its previous repurchase authorization from June 11, 2003.

"In the past year, the company has returned significant value to shareholders by repurchasing $518.5 million, or 10.6 million, of its shares," Ernst said. "The new repurchase authorization reflects the confidence that the board of directors has in H&R Block's future. Given our strong cash position, share repurchase continues to be a great way for us to enhance shareholder value."

During the fourth quarter, the company repurchased 2.8 million shares at an average cost of $52.77 per share.

U.S Tax Operations

For the fiscal year, U.S. tax operations reported pretax income of $627.6 million, an increase of 14.7 percent from pretax income of $547.1 million in fiscal 2003.

U.S. tax operations reported a 3.2 percent increase in fourth quarter pretax income, which totaled $783.5 million, up from $759.3 million in the fourth quarter of fiscal 2003.

The segment's revenues for the year increased 12.5 percent to $2.1 billion. The increase was driven by an 8 percent increase in the average fee per client served, the acquisition of former major franchise territories during fiscal year 2004, and a change from last year's contractual agreement with Household Taxmasters Inc. that resulted in increased revenues from refund anticipation loan (RAL) participation.

The segment reported $1.5 billion in revenues for the fourth quarter, an increase of 10.1 percent compared with last year's fourth quarter.

"We improved client satisfaction with our combination of financial information and tax services, which is a unique value of the H&R Block brand. And we made solid progress with our multi-channel strategy. The number of software and online clients increased 12.2 percent to 3.2 million, with the fastest growth in tax

solutions that blend the services of a tax professional with software and online products," Ernst said.

"While we're disappointed in the 0.8 percent decline in clients served, we understand the factors behind the decline and are taking steps to strengthen our market position. We will open 500 to 600 new offices in underserved areas where we could not provide the convenience clients wanted. And we are reviewing our marketing plans to identify the best mix of messages, products and services to drive client growth in the early part of tax season."

Mortgage Operations

Mortgage operations, which includes Option One Mortgage Corp. and H&R Block Mortgage Corp., reported fourth quarter pretax income of $175.9 million, a 34.4 percent increase, compared with $130.9 million in the fourth quarter last year.

For fiscal 2004, the mortgage segment reported pretax income of $678.3 million, a 2.3 percent decrease compared with $694.0 million in pretax income in fiscal 2003.

Fourth quarter revenues grew 28.4 percent to $344.3 million, up from $268.3 million the prior year. Fiscal 2004 revenues increased 10 percent to $1.3 billion, up from $1.2 billion in fiscal 2003.

For fiscal 2004, gains on sales of mortgage loans increased 8 percent to $716.7 million, compared with $663.6 million in fiscal 2003. In fiscal year 2003, the company reported a $130.9 million gain on the sale of previously securitized residual interests, compared to $40.7 million in the current year. Net of $30.7 million in impairments of older residuals, compared with $54.1 million in 2003, the mortgage segment's total gains on sales were $726.7 million for fiscal 2004, compared to $740.3 million in the prior year.

Loan production increased to $23.3 billion in fiscal 2004, a 40.3 percent increase over the previous year. An increase in the number of loan specialists, improvements in the company's closing ratio, and a 4.9 percent increase in the average loan size all contributed to this growth.

Included within these results, H&R Block Mortgage Corp., H&R Block's retail mortgage subsidiary, originated 6.4 percent more loans, 48.9 percent of which were made to retail clients of other H&R Block businesses.

"The mortgage business performed as we expected it would. We saw continued growth in mortgage originations and lower margins due to the anticipated increase in interest rates," Ernst said.

"Originations have been strong across all of our origination channels, and loan performance has exceeded modeled expectations. We continue to manage our mortgage business to optimize cash earnings, and we remain confident that mortgage operations will continue to perform well," he said.

Option One's mortgage servicing business increased the number of loans serviced 31.6 percent to 324,364. The servicing portfolio at year-end increased 44.7 percent to $45.3 billion, compared with last year's portfolio.

The segment's residual interests continued to perform better than expected, primarily due to better than modeled credit losses and interest rates. Consequently, the company realized a net write-up to residual balances of $167.1 million during fiscal year 2004, including $67.1 million in the fourth quarter, which was recorded in other comprehensive income on the balance sheet, net of deferred taxes.

Business Services

RSM McGladrey Business Services, Inc. reported fourth quarter pretax earnings of $26.8 million, compared with a net loss of $1.9 million in the same quarter last year. For fiscal 2004, the segment reported pretax earnings of $19.3 million, compared with a net loss of $14.1 million in 2003.

In the fourth quarter, the business services segment reported revenues of $179.4 million, an increase of 28 percent. For the fiscal year, revenues increased 15 percent to $499.2 million.

"We are beginning to realize the potential that exists in this business segment. Our capital markets business enjoyed a strong year, and an improving economic environment for our middle market clients resulted in higher revenues in our core accounting and tax services," Ernst said.

Fiscal year 2003 includes a goodwill impairment charge of $11.8 million related to the segment's payroll and benefits processing company. The segment wrote off $576,000 in intangible assets in the fourth quarter of 2004.

Investment Services

Investment services reported a fourth quarter pretax loss of $22.5 million, an improvement of $13.3 million from a fourth quarter loss last year of $35.8 million. For the fiscal year, investment services recorded a pretax loss of $64.4 million, an improvement of $63.8 million compared with a loss of $128.3 million in fiscal 2003. Fiscal year 2003 results include $24 million of goodwill impairment charges.

Investment services reported fourth quarter revenues of $62 million, a 40.8 percent increase from the same quarter last year. Revenues for the fiscal year increased 14.3 percent to $229.5 million.

***"We see continued improvement in H&R Block Financial Advisors' results. We believe that this business has been restructured in a way that allows us to compete effectively as the investment climate improves," Ernst said.***

***"The retention and recruitment of experienced advisors continues to be a key initiative in the upcoming year, along with building stronger links between financial advisors and tax professionals in our U.S. tax operations."***

24. On July 23, 2004, defendants filed SEC Form 10-K. The filing stated in part:
I T E M 9 A . CONTROLS AND PROCEDURES

Disclosures controls are procedures that are designed with the objective of ensuring that information required to be disclosed in reports filed or under the

Securities Exchange Act of 1934, such as this Form 10-K, is recorded, processed, summarized and reported in accordance with the SEC's rule. Disclosure controls are also designed with the objective of ensuring that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer or persons performing similar functions, as appropriate, to allow timely decisions regarding disclosure.

Our Disclosure Controls were designed to provide reasonable assurance that the controls and procedures would meet their objectives. Our management, including the CEO and Principal Accounting Officer, does not expect that our Disclosure Controls will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the designed control objectives and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simply error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusions of two or more people, or by management override of the control.

Because of the inherent limitations in a cost-effective, maturing control system, submitted misstatements due to error or fraud may occur and not be detected. As of the end of the period covered by this Form 10-K, we evaluated the effectiveness of the design and operation of our Disclosure Controls. The controls evaluation was done under the supervision and with the participation of the management, including our CEO and Principal Accounting Officer.

The evaluation of our Disclosure Controls included a review of the controls' objectives and design, our implementation of the controls and the effect of the controls on the information generated for the use in this Form 10-K. In the course of the controls evaluation, we identified a series of control weaknesses related to our corporate tax accounting function. These weaknesses relate specifically to the reconciliation and level of detailed support of both current and deferred income tax accounts. We also determined an acceleration of taxable income was warranted in one of our segments, however, there was no change to our total income tax provision. Upon identification of these control weaknesses, immediate corrective action was undertaken. Our efforts to strengthen financial and internal controls continue. We expect these efforts to be completed by the end of fiscal year 2005.

***Based on this evaluation, other than the item described above, our CEO and Principal Accounting Officer have concluded these controls are effective. There have been no significant changes in internal controls, or in other factors, which would significantly affect these controls subsequent to the date of evaluation.***

***

25. On August 24, 2004, the Company issued a press release entitled, "H&R Block Reports First Quarter Financial Results - The company reported a loss of 26 cents per diluted share, compared to 3 cents of earnings last year". The press release stated in part:

> KANSAS CITY, Mo. -- H&R Block Inc. (NYSE: HRB) today reported a $44.1 million net loss for its first quarter, compared with earnings of $5.2 million last year. Revenues totaled $482.7 million, a 2.6 percent decline from last year. The company reported a loss of 26 cents per diluted share, compared to 3 cents of earnings last year.
>
> The decline in earnings was primarily due to decreased mortgage segment income and additional off-season costs associated with expanding the company's tax business.
>
> "The first quarter loss is in line with our internal expectations, and consistent with our annual earnings guidance range of $4 to $4.25 per share," said H&R Block Chairman and Chief Executive Officer Mark A. Ernst. "This quarter we also repurchased 7.5 million shares in accordance with our objective to return excess capital to shareholders.
>
> "In our mortgage unit, loan production increased more than 28 percent for the quarter, while margins declined because of the increase in market interest rates. We expected margin compression in the first two quarters of our fiscal year, with improved earnings performance in the second half of the year after adjusting to the higher rate environment. Our mortgage business is on track to meet our expectations for the year," Ernst said.
>
> In its first quarter, H&R Block acquired 7.5 million shares of its common stock at an aggregate cost of $347.4 million, or an average price of $46.56 per share. Over the past year, the number of H&R Block shares outstanding has declined 6.8 percent to 166.2 million shares outstanding.
>
> The first quarter results include $4.6 million in stock-based compensation expense, compared with $1 million last year. H&R Block began to expense the costs of all stock-based compensation at the beginning of fiscal year 2004.
>
> The prior year results include a change in accounting principle related to the adoption of Emerging Issues Task Force No. 00-21 (EITF 00-21) as of May 1, 2003. This change reduced last year's first quarter net income by $6.4 million, or 3 cents per diluted share.
>
> Tax Services
>
> Beginning with the first quarter of fiscal year 2005, the company has aggregated its U.S and International tax services into one segment.
>
> Tax services revenues increased 9.7 percent to $50.4 million. The segment reported a pretax loss of $113 million, which was 13.5 percent higher than the pretax loss of $99.6 million in the first quarter of fiscal 2004. Results were negatively affected by an additional $9 million in off-season losses related to

former major franchise territories acquired during the second quarter of fiscal year 2004.

"We're on pace to open 500 to 600 new offices in under-penetrated areas where we see growth opportunities. We also expect to add 400 more Wal-Mart locations," Ernst said. "We are confident in the value that clients receive from H&R Block and are working to make our services even more accessible."

Mortgage Services

Mortgage services, which include Option One Mortgage Corp. and H&R Block Mortgage Corp., reported first quarter pretax income of $93.5 million, a 42.9 percent decrease, compared with $163.8 million in the first quarter last year.

First quarter revenues declined 8.4 percent to $268.1 million, from $292.6 million the prior year.

The mortgage segment's total gains on sales were $137.5 million for the first quarter, a 24.6 percent decline compared with $182.3 million in the prior year's first quarter.

Loan production increased to a record $6.8 billion for the quarter, a 28.4 percent increase over the previous year's quarter. An increase in the number of loan applications, improvements in the company's closing ratio, and an increase in the average loan size all contributed to this growth.

Included within these results, H&R Block Mortgage Corp., H&R Block's retail mortgage subsidiary, reported a 7.8 percent decline in originations. About 48 percent of H&R Block Mortgage's loans were made to retail clients of other H&R Block businesses.

"I'm confident in the actions we have taken to position the business for success in this changing rate environment. We are increasing our distribution capability and improving our ability to serve clients and sustain our competitive position as a service leader. We believe these investments, along with reduced interest rate volatility, will result in another year of strong mortgage financial results," Ernst said.

The segment's residual interests continued to perform better than expected, primarily due to better than modeled credit losses. Consequently, the company realized a net write-up to residual balances of $53.5 million during the first quarter of fiscal year 2005, which was recorded as other comprehensive income, net of deferred taxes. The company did not realize any gains from the sale of residual assets in the quarter.

Business Services

Business services reported a first quarter pretax loss of $10.1 million, compared with a pretax loss of $6.7 million in the same quarter last year. The segment reported revenues of $109.1 million, an increase of 10.8 percent.

A significant backlog in the capital markets business at the end of fiscal year 2003 increased first quarter revenue and earnings last year, which affected the year to year comparison with the first quarter of 2005.

"Our core accounting and tax services enjoyed a strong off-season quarter. It's encouraging that most of our increased revenue is the result of our strategic growth initiatives, including the development and implementation of a marketing and sales infrastructure. We're well-positioned to capitalize on the opportunity this market offers," Ernst said.

*Investment Services*

***Investment services reported a first quarter pretax loss of $18.3 million, an increased loss of $4.5 million compared with last year's $13.8 million loss.***

***Investment services reported first quarter revenues of $53.6 million, a 6 percent decrease from the same quarter last year.***

***"We're disappointed with investment services' first quarter results, which are consistent with the weak investment climate affecting the entire industry. However, I'm confident that our business has been positioned in a way that will allow us to grow in support of the investment needs of our clients," Ernst said.***

***

26. On October 22, 2004, the Company issued a press release entitled, "H&R Block to Issue $400 Million in 10-Year Notes"[4]. The press release stated in part:

> Block Financial Corp., a subsidiary of H&R Block Inc. (NYSE: HRB), today announced that it has priced and will issue $400 million in 10-year senior unsecured notes to be unconditionally guaranteed by H&R Block. The notes will bear an interest rate of 5 1/8 percent per year and will mature in 2014.
>
> The company expects to use the proceeds from the offering for general corporate purposes, including the repayment of $250 million 6 3/4 percent senior notes when they come due in November 2004.
>
> A registration statement relating to these securities has been filed with the Securities and Exchange Commission and has become effective. This press release shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful under the securities laws of any such state.
>
> JPMorgan Securities, Inc. and Merrill Lynch & Co. serve as co-lead underwriters and joint bookrunners for the transaction. Citigroup Global Markets Inc., Goldman Sachs & Co. and H&R Block Financial Advisors Inc. are serving as co-managers.

[4] The documents underlying and incorporated by this press release include defendants' SEC Form S-3 filed on August 6, 2004, SEC Form 424B3 filed on October 22, 2004, SEC Form 424B5 filed on October 26, 2004 and SEC Form 8-K filed on October 21, 2004.

27. On November 23, 2004, the Company issued a press release entitled, "H&R Block Reports Second Quarter Financial Results - Lower full-year earnings guidance on Mortgage outlook". The press release stated in part:

> H&R Block Inc. (NYSE: HRB) today reported a $52.2 million net loss for the second quarter of its 2005 fiscal year, compared with earnings of $10.4 million in the second quarter last year. Revenues totaled $539.3 million, a 5.2 percent decline from last year. The company reported a loss of 32 cents per diluted share, compared with 6 cents of earnings last year.
>
> The decline in earnings was due primarily to decreased income in the mortgage segment. An asset write-down in investment services and corporate development spending associated with new business initiatives also contributed to the earnings decline. Historically, H&R Block has reported second quarter losses because of the seasonal nature of its tax and accounting businesses, although the company reported a profit in the second quarter of fiscal 2004.
>
> "The competitive environment in the mortgage industry limited our pricing flexibility in the face of rising interest rates in the secondary market," said Chairman and Chief Executive Officer Mark A. Ernst. "In view of industry-wide trends, we were satisfied with our levels of loan originations, which grew 2.7 percent compared with the second quarter last year, although operating margins did not improve as much as we had anticipated.
>
> "We will begin deploying a series of technology enabled service enhancements to our mortgage broker clients during the fourth quarter. We believe that these will improve productivity and position our mortgage business for success as we transition to a higher rate environment. Primarily due to the current mortgage pricing environment and investments in support of these technology enhancements, we are lowering our current fiscal year earnings guidance to the range of $3.50 to $4.00 per share," Ernst said.
>
> In the second quarter, H&R Block acquired 3.8 million shares of its common stock at an aggregate cost of $182.2 million, or an average price of $47.81 per share. Over the past year, the number of H&R Block shares outstanding has decreased 8 percent to 163.5 million shares outstanding.
>
> The second quarter results include $7.9 million in stock-based compensation expense, compared with $3.1 million last year. H&R Block began to expense the costs of all stock-based compensation at the beginning of fiscal year 2004.
>
> For the six months ended Oct. 31, H&R Block reported a net loss of $96.3 million, or 58 cents per diluted share, compared with earnings of $15.5 million last year, or 9 cents per diluted share. Revenues for the six-month period decreased 4 percent to $1 billion, from $1.1 billion last year.
>
> The prior year results include a change in accounting principle related to the adoption of Emerging Issues Task Force No. 00-21 (EITF 00-21) as of May 1, 2003. This change reduced last year's first quarter net income by $6.4 million, or 3 cents per diluted share.

Tax Services

Tax services revenues increased 11.8 percent to $74.1 million. The segment reported a pretax loss of $134 million, which was 2.8 percent higher than the pretax loss of $130.4 million in the second quarter of fiscal 2004.

For the six-month period, revenues were $124.6 million, up $12.3 million from $112.3 million last year, a 10.9 percent increase. The pretax loss for the six-month period was $247 million, $17 million, or 7.4 percent, higher than last year.

"We continue on pace to open more than 600 new offices and 400 additional Wal-Mart locations. This investment in expanding our office network will make our tax services more accessible and convenient to a greater number of tax filers, which we expect will drive client growth this tax season. Our off-season costs remain in line with our expectations," Ernst said.

***

***Investment Services***

***Investment services reported a second quarter pretax loss of $24.6 million, an increase of $9.2 million compared with last year's $15.3 million loss. The second quarter loss included a $6 million write-down of a branch office facility. Investment services reported second quarter revenues of $53.8 million, a 2 percent increase from the same quarter last year.***

***The pretax loss for the second quarter increased 34.5 percent, or $6.3 million compared with the first quarter of fiscal year 2005. Revenues improved slightly, up .3 percent compared with first quarter revenues of $53.6 million.***

***For the six-month period, revenues decreased 2.1 percent to $107.3 million from $109.7 million last year. The pretax loss increased $13.7 million, or 47.2 percent compared with a loss of $29.1 million for the first six months of fiscal year 2004.***

***"The general market climate for investment services remained very weak during the early months of the quarter, though we began to see improvement in October and into November," Ernst said.***

Dividend declared

H&R Block's board of directors declared a quarterly cash dividend of 22 cents per share, payable Jan. 3, 2005, to shareholders of record Dec. 13, 2004. This payment will be the company's 169th consecutive quarterly dividend.

28. On February 24, 2005, the Company issued press release entitled, "H&R Block Reports 55 Cents Per Share Third Quarter Profit - Increases in Tax Clients and Mortgage Originations Highlight Strong Quarter". The press release stated in part:

H&R Block Inc. (NYSE:HRB) today reported net income of $91.7 million, or 55 cents per diluted share, for the third quarter ended Jan. 31, 2005. Revenues in the third quarter were a record $1.03 billion, a 7.2 percent increase over the prior year's quarter.

"A strong start to the tax season combined with solid performances from our mortgage and business services segments were highlights of a good quarter," said Mark A. Ernst, chairman and chief executive officer. "I'm particularly pleased that the strategic actions taken in our tax and mortgage businesses are generating success in their respective markets."

Early tax season results through Feb. 15 included a 10.6 percent increase in total tax preparation and related fees over the comparable period last year, paced by 4 percent retail client growth and a 6.3 percent increase in average fees per retail client.

"The performance thus far is consistent with our expectations for a good tax filing season, supported by strong, new client acquisition, solid retention and increased client satisfaction with our services," Ernst said.

Mortgage results included a 56.8 percent increase in loan originations to $8.4 billion over the comparable quarter last year, and a 28.9 percent increase from the previous quarter's origination levels. Continued aggressive pricing in the mortgage market limited gain-on-sale margins. At the same time, progress was made in the company's effort to lower overall cost of origination, offsetting a significant share of the gain-on-sale margin reduction.

"We're very pleased with the performance of our mortgage business, where our strategy to expand service capacity is leading to strong origination volume growth despite the slowing industry," Ernst said. "In addition, we made considerable progress in lowering the cost of origination, reducing it by 37 basis points in the third quarter alone. This is consistent with our objective to realize a sustained 50 to 75 basis point reduction over the next 12 to 18 months."

Third quarter results include $12.5 million, or 5 cents per share, in stock-based compensation expense. The expense was $6.8 million in the previous year. In addition, the results reflect a $16.7 million litigation payment made to H&R Block.

For the nine months ended Jan. 31, H&R Block reported a net loss of $4.6 million, or 3 cents per diluted share, compared with net income of $122.3 million, or 67 cents per diluted share, in the prior year. The reduction was due primarily to declining income from the mortgage segment as competitive pricing has reduced margins across the industry.

Tax Services

A 3.7 percent increase in retail tax clients, combined with higher average fees per client, helped drive revenue and income increases in the tax segment for the third quarter. Tax services revenues climbed 11.9 percent to $531.1 million compared with last year, while pretax income improved 4.1 percent to $64.3 million.

Early tax season results from Jan. 1 through Feb. 15 show that tax preparation and related fees from retail tax offices increased 10.6 percent to $1.2 billion. The average fee per client rose 6.3 percent to $143.90. Retail tax offices served 8.3 million clients through Feb. 15, while total clients served, including digital tax clients, increased 1.4 percent.

"More than any other factor, the success we're experiencing can be attributed to the quality of service our tax professionals are providing to our clients," Ernst said. "Expansion of our office network, operational improvements and successful marketing mean that more consumers are benefiting from that service."

H&R Block's digital tax business, including its award-winning TaxCut® software and online tax services, reported a 9.1 percent decrease in paid clients served through Feb. 15. Modest growth in online clients was offset by a decline in software units sold.

"Both consumer and competitive changes in the digital tax market have restricted the client growth that we expected this season. However, we will continue to follow a disciplined approach to pricing and marketing our digital services, although it may limit our ability to achieve this year's client growth objectives," Ernst said.

For the nine-month period, tax services revenues rose 11.7 percent to $655.6 million, while the pretax loss of $182.6 million was 8.6 percent higher than a year ago.

***

**Reasons For Falsity**

29. Defendant H&R Block offers accounting, tax, and consulting services to middle-market companies. Nevertheless, the financial statements issued this tax and accounting services business during the Class Period were false and misleading, as such financial information was not prepared in conformity with generally accepted accounting practices ("GAAP"), nor was the financial information a fair presentation of the Company's operations due to the Company's improper accounting, in violation of GAAP and SEC rules.

30. Moreover, during the Class Period, defendants were aware or in conscious and reckless disregard of the fraudulent marketing practices they had adopted for the offering of retirement products within the Company's troubled Financial Advisory segment. Quarter after quarter, defendants noted heavy losses within their investment services business. Defendants knew that their efforts to offer IRA investment products to their tax clients was being met with resistance by investment professionals, since the fees associated with the accounts typically